Abuse of Tax Treaties: a Discussion of Recent Court Cases in Various Countries with Opposite Outcomes

Conference paper, to be published in: *R. Danon, Double Taxation Conventions: Latest Development*s, 3rd Symposium of International Tax Law. Schulthess, Zurich 2010 (18 p.)
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ABUSE OF TAX TREATIES: A DISCUSSION OF RECENT COURT CASES IN VARIOUS COUNTRIES WITH OPPOSITE OUTCOMES

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1. Introduction

This paper discusses ten court cases in various countries that deal with abuse of tax treaties. Chapter 2 will deal with the issue of whether there is an inherent anti-avoidance rule in double taxation conventions which do not contain any specific anti-avoidance provisions. It will first provide some background to the inherent anti-avoidance doctrine and then examine A Holding ApS (Swiss Federal Court), MIL Investments (Canadian Tax Court), two Dutch cases and Yanko-Weiss Holdings (Israeli District Court). Chapter 3 looks at the concept of beneficial ownership. This section firstly presents a brief introduction to the concept of beneficial ownership and next comments on Bank of Scotland (French Supreme Court), Indofood (English Court of Appeal), Indah Kiat BV (Indonesian District Court), Transportasi (Indonesian Tax Court) and Prévost (Canadian Tax Court). Chapter 4 will then conclude with a summary.

2. Is there an inherent anti-avoidance rule in double taxation conventions which do not contain any specific anti-avoidance provisions?

2.1. Background

The 1977 commentary on article 1 of the OECD model convention stated that tax treaties should not enable tax avoidance or evasion. Paragraph 7 provided that it was: “for the States concerned to adopt provisions in their domestic laws to counter possible manoeuvres. Such States will then wish, in their bilateral double taxation conventions, to preserve the application of provisions of this kind contained in their domestic laws.” According to De Broe, the 1977 commentary therefore clearly implied that domestic anti-avoidance measures could not be applied to tax treaties, even if states perceived certain behaviour of taxpayers as abusive.[2]

The commentary on article 1 was revised in 1992. Several paragraphs were added that indicated that a large majority of OECD member states considered that substance over form rules and CFC provisions “are part of the basic domestic rules set by national tax law for determining which facts give rise to a tax liability. These rules are not addressed in tax treaties and are therefore not affected by them.”[3] Other states, however, held that such rules were subject to the general provisions of tax treaties against double taxation, especially where the treaty itself contained provisions aimed at counteracting its improper use. According to the commentary it was not easy to reconcile these divergent opinions: “The main problem seems to be whether or not general principles such as "substance-over-form" are inherent in treaty provisions, i.e. whether they can be applied in any case, or only to the extent they are expressly mentioned in bilateral conventions.”[4]

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[2] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 377.
[3] Par. 23 of the 1992 commentary on article 1 of the OECD model.
[4] Par. 24 of the 1992 commentary on article 1 of the OECD model.

There is a general feeling amongst commentators that the 1992 commentary was confusing in dealing with the abuse of tax treaties.[5]

In 2003 the OECD's position regarding the relationship between tax treaties and tax avoidance was revised again. In paragraph 7 of the commentary on article 1 it is now emphasised that it is also a purpose of tax conventions to prevent tax avoidance and evasion. As a treaty should be interpreted in light of its purpose, the provisions of a treaty should be interpreted to prevent tax avoidance.[6]

In paragraph 9.2, the commentary addresses the question whether the provisions of tax conventions may prevent the application of the anti-abuse provisions of domestic law. The answer to that question is that "to the extent these anti-avoidance rules are part of the basic domestic rules set by domestic tax laws for determining which facts give rise to a tax liability, they are not addressed in tax treaties and are therefore not affected by them. Thus, as a general rule, there will be no conflict between such rules and the provisions of tax conventions." This response has been criticised by Arnold en Van Weeghel who argue that the real issue starts where the facts have been properly determined, but then the application of a domestic anti-avoidance rule leads to the substitution of facts that avoid taxation for facts that will lead to taxation.[7] They question whether: "even for treaties concluded after the 2003 revision, absent a specific treaty provision that preserves the application of domestic anti-avoidance rules, courts in some countries will find the application of such rules consistent with treaty obligations."[8]

The commentaries also deal with the issue of whether the benefits of tax conventions must be granted when transactions that constitute an abuse of the provisions of these conventions are entered into. In this case states do not have to grant the benefits of a double taxation convention.[9]

In paragraph 9.5 the commentaries discuss when an abuse is present: "A guiding principle is that the benefits of a double taxation convention should not be available where a main purpose for entering into certain transactions or arrangements was to secure a more favourable tax position and obtaining that more favourable treatment in these circumstances would be contrary to the object and purpose of the relevant provisions." Therefore treaty benefits can only be denied if two conditions are met. Foremost one of the main purposes[10] of a transaction must be to obtain treaty benefits and next obtaining the benefits would be contrary to the object and purpose of the treaty.

2.2. Swiss Federal Court: A Holding ApS

In December 1999, A Holding ApS ("A Holding"), a company resident in Denmark, purchased all shares in F AG, a company resident in Switzerland. A Holding was a letterbox company. On 30 November 2000 F AG distributed dividend in the amount of CHfr.5.5 million. F AG paid 35% of this amount as withholding tax to the Swiss tax authorities. The rest was paid to A Holding and the funds received were distributed by A Holding to its shareholder, C. Ltd, a company domiciled in

[5] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 380, footnote 386.

[6] According to Arnold, however, it is not clear in any particular case that a treaty's purpose to prevent tax avoidance would the most important factor in interpreting the treaty. B.J. Arnold, Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model, Bulletin June 2004, p. 249.

[7] B.J. Arnold and S. van Weeghel, The relationship between tax treaties and domestic anti-abuse measures, Tax Treaties and Domestic Law, EC and International Tax Law Series Vol. 2, IBFD Amsterdam 2006, p. 91.

[8] B.J. Arnold and S. van Weeghel, The relationship between tax treaties and domestic anti-abuse measures, Tax Treaties and Domestic Law, EC and International Tax Law Series Vol. 2, IBFD Amsterdam 2006, p. 91.

[9] Paragraph 9.4 of the commentary on article 1 of the 2003 OECD model.

[10] Arnold and Van Weeghel emphasise that it is significant that the commentary requires only that one of the main purposes and not that the sole principal purpose of a transaction is to obtain treaty benefits. B.J. Arnold and S. van Weeghel, The relationship between tax treaties and domestic anti-abuse measures, Tax Treaties and Domestic Law, EC and International Tax Law Series Vol. 2 IBFD Amsterdam 2006, p. 93.

Guernsey, on 15 December 2000. C Ltd was held by D Ltd which was domiciled in Bermuda. The director of D Ltd was E who had its seat in Bermuda.

Under article 10 of the tax treaty between Switzerland and Denmark dividends paid by a resident of Switzerland to a person residing in Denmark are taxable only in Denmark. On this basis A Holding applied for the reimbursement of the withholding tax. The Swiss tax authorities, however, rejected the claim on the ground that A Holding was only incorporated for the purpose of benefiting from the advantages of the treaty.

The tax treaty did not contain any anti-abuse provision. The federal court considered, however, that when applying an international convention, good faith, the aim and the purpose of a convention are to be taken into account. The federal court further held that this included the tackling of abuses: "the prohibition of abuses is part of the principle of good faith"[11] Additionally, the court recognised that the principle of abuse of rights is recognised in Denmark. Furthermore, Denmark had during the negotiations of the treaty not made a reservation against the application of the Swiss anti-abuse resolution of 1962.

The court then stated that Switzerland and Denmark, as member states of the OECD, were in principle obliged to take into account the OECD model and the commentary: "The OECD model conventions and the relating commentaries of the last years increasingly contain statements on the abuse of conventions (…). However, this was not the case when the Swiss-Danish double tax convention was concluded in 1973. But the later commentaries are supplementary means of interpretation since they are intended amendments of already existing rules (…). According to para 9.4 of the OECD commentary to art 1 of the OECD model 2003 it may be regarded as an internationally accepted principle that states do not have to grant advantages of double tax conventions if arrangements have been chosen which constitute an abuse of a convention (…)."[12]

The court then looked at the question of whether A Holding abused the treaty. The court used the commentaries to the 2003 OECD model to find guidance as to the circumstances which could constitute abuse. More in particular, the court examined the transparency provision of paragraph 13 of the 2003 OECD commentary. Under this provision, treaty benefits are disallowed to a company that is not owned, directly or indirectly, by residents of the state of which the company is resident. Had the treaty contained a look through provision, it would have applied to A Holding since the company was indirectly controlled by a resident of Bermuda. However, as the treaty did not contain a look through provision, an abuse could only be assumed if the Danish company did not carry out a real economic activity or an active business activity.

The court went on to say that: " [i]t follows that the objection of an abuse of a convention is unfounded if the company demonstrates that its main purpose, its management and the acquisition as well as the holding of participations and other assets from which the income in question arises, is primarily based on valid economic grounds and not aimed at the obtaining of advantages of the applicable double tax convention (so-called 'bona fide'-provision). The same applies if the company pursues effectively a commercial activity in its state of residence and the tax relief claimed in the other contracting state relates to income connected to this activity (so-called activity-provision)."[13] A Holding did not fulfil either of these conditions. Therefore the Federal Court confirmed that the tax authorities lawfully denied the reimbursement of the withholding tax.

Comments

The court derives its conclusion that the prohibition of abuses is part of the principle of good faith first and foremost from the commentary on article 1 of the 2003 OECD Model. If a provision in a

[11] Swiss Federal Court, 28 November 2005, 8 ITLR 557.
[12] Swiss Federal Court, 28 November 2005, 8 ITLR 558.
[13] Swiss Federal Court, 28 November 2005, 8 ITLR 560/561.

tax treaty signed between OECD member states corresponds with the OECD model convention, the parties apparently intended to interpret the article in question in accordance with the commentary applicable at the time the treaty was negotiated. They would have been familiar with that version of the commentary when they signed the treaty. The treaty between Switzerland and Denmark, however, was concluded in 1973 and predates the 2003 commentary. It is therefore submitted that the 2003 commentary can only be relevant in interpreting the Swiss-Danish treaty to the extent it clarifies the version of the commentary that applied when the treaty was negotiated (i.e. the 1963 commentary).

The OECD's position on abuse of tax treaties considerably changed in 2003, particularly when compared to the position taken in the 1977 commentary. The prevention of tax avoidance is now a goal of the model convention. In addition to this, states do not have to grant the benefit of a tax treaty in cases where the treaty is abused. For this reason, the present author believes that the 2003 commentary cannot shed light on tax treaties that were concluded when the 1977 commentary applied.[14] The 1963 commentary, however, was silent on the issue of abuse of tax treaties. That means first of all that the 2003 commentary does not necessarily conflict with the 1963 commentary. That does not, however, automatically imply that the 2003 commentary clarifies the 1963 commentary.

The court's reasoning is even more remarkable as it completely ignores the observation that Switzerland made on the 2003 commentary on article 1. According to this observation "Switzerland does not share the view expressed paragraph 7 according to which the purpose of double taxation conventions is to prevent tax avoidance and evasion."

In explaining why the prohibition of abuses is part of the principle of good faith, the court also referred to Prokish, who comments on the commentary on article 1 as follows: "Wie hier an anderer Stelle schon ausgeführt wurde (…), is eine künstliche, unangemessene Rechtsgestaltung nicht nach Massgabe ihrer Form, sondern allein nach ihrer Substanz zu beurteilen. Nach der Auffassung dieses Kommentars gilt diese, - zunächst - innerstaatliche Regel als ein "allgemeiner Rechtsgrundsatz der zivilisierten Nationen" auch im Verhältnis der Vertragsstaaten eines DBA zueinander (…). Die völkerrechtliche Verpflichtung aus einem Doppelbesteuerungsabkommen gegenüber dem anderen Vertragsstaat steht also unter einem allgemeinen völkerrechtlichen "Umgehungsvorbehalt". Er beschränkt die völkerrechtliche Verbindlichkeit des Abkommens, damit aber auch die innerstaatliche, da in Abkommen nur mit dem Inhalt innerstaatlichs Recht wird, mit dem es kraft Völkenrechts gilt (…)."[15] Other commentators do, however, not share this view and have argued that the international public law doctrine of the abuse of rights remains vague and imprecise[16] and that, even if one recognises the principle, it is not clear how to deal with it in connection with tax treaties.[17]

The court further seemed to refer to the practice of Denmark in the application of the treaty as it observed that the principle of abuse of rights is recognised in Denmark. The court did, however, not explore this doctrine. De Broe points out that in order to determine the common intentions of Denmark and Switzerland the court should have examined whether Denmark had applied its

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[14] Contra Arnold and Van Weeghel who are of the view that it can be argued that at least to a certain extent the changes in the 2003 commentary are clarifying in nature. B.J. Arnold and S. van Weeghel, The relationship between tax treaties and domestic anti-abuse measures, Tax Treaties and Domestic Law, EC and International Tax Law Series Vol. 2 IBFD Amsterdam 2006, p. 101.

[15] R. Prokish in K. Vogel, M. Lehner, Doppelbesteuerungsabkommen 4 Aufl, Verlag C.H. Beck München 2003, p. 284/285.

[16] [16] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 307.

[17] S. van Weeghel, Improper Use of Tax Treaties, PhD thesis Amsterdam, Kluwer Law Internatiomal 1997, p. 100.

abuse-doctrine in the reverse situation.[18] The court also looked at similar treaties between Denmark and third states as it mentioned that Denmark had entered in the meantime into tax conventions with anti-abuse provisions.

Additionally the court paid attention to the historical background against which the treaty was negotiated. The court stated that Denmark had during the negotiations of the treaty not made a reservation against the application of the Swiss anti-abuse resolution of 1962. This resolution only applies to reverse cases where the source of income is located in the other state and not in Switzerland. The court pointed out that this resolution enabled Switzerland to act against abuses of tax treaties to the detriment of the other contracting state without having specific anti-abuse provisions for in the treaty.

In considering whether A Holding abused the treaty, the court did not apply the guiding principle provided by paragraph 9.5 of the commentary on article 1. Consequently it did not investigate whether the reimbursement of the withholding tax would be contrary to the object and purpose of the dividend article of the treaty between Switzerland and Denmark. It is submitted that the court could have read the requirement of beneficial ownership into the dividend article of the treaty in order to determine if the treaty was abused. Instead it based its conclusion on the look through provision. According to the 2003 commentary this provision is one of the models that treaty negotiators might consider when dealing with conduit companies. This means that the issue of whether there is an abuse was decided pursuant to an article that is neither incorporated in the OECD model, nor included in the tax treaty between Switzerland and Denmark. In explaining its view the court pointed out that the rationale of the 1962 anti-abuse resolution is similar to the underlying principle of the look through provision. The role that this resolution played in the decision-making of the court can hardly be overestimated.

2.3 Canadian Tax Court: MIL (Investments)

In 1993 MIL (Investments) SA (“the appellant”), a newly incorporated Cayman Islands company, acquired a minority stake in Diamond Field Resources Ltd (“DFR”), a public company incorporated in Canada and traded on the Toronto stock exchange, from its sole shareholder, Mr. Boulle. In 1994 DFR discovered a major deposit of nickel, copper and cobalt near Voisey Bay (“ the property”). In June 1995, DFR sold a minority stake in the property to Inco Ltd (“Inco”). At that time the appellant exchanged some of its DFR shares for common shares in Inco. Prior to that date the appellant had 11.9% of the DFR shares and after that date the appellant’s shareholding was 9.6%. In July 1995, the appellant was continued in Luxembourg. In August 1995, the appellant disposed of its shares in Inco and in September the appellant sold some of its DFR shares. The appellant claimed exemption from Canadian tax on the resulting capital gains on the sales under article 13 of the tax treaty of 1990 between Canada and Luxembourg. It was not assessed in Canada respecting these gains and paid no tax in Luxembourg. In October 1995 one of DFR’s key persons suddenly died and the DFR directors realised that it was going to be very difficult to maintain independence. By the end of 1995, Inco made an offer to acquire the DFR shares. In 1996 the DFR shareholders approved the Inco acquisition of all DFR shares. The appellant realised a capital gain of C$ 425.8 million and claimed an exemption from Canadian tax under article 13 of the treaty. The Canadian tax authorities denied the exemption on the ground of the domestic general anti-avoidance rule (“GAAR”).[19] In addition they denied the exemption on the basis that there was an anti-avoidance rule inherent in the treaty.

[18] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 446.

[19] Canadian law provides that in the event of a conflict between the GAAR and a tax treaty, the GAAR prevails. This means that conflicts between tax treaties and the GAAR can never rise in Canada. B.J. Arnold and S. van Weeghel, The relationship between tax treaties and domestic anti-abuse measures, in: Tax Treaties and Domestic Law, EC and International Tax Law Series Vol 2, IBFD Publications BV Amsterdam 2006, 116.

The GAAR provides that an avoidance transaction means any transaction that, but for the GAAR, would result in a tax benefit or that is part of a series of transactions, which series, but for the GAAR, would result in a tax benefit. The Tax Court considered that it was unimaginable that Boulle could have persuaded other shareholders to vote in favour of a sale simply because he alone might enjoy a tax benefit. Therefore it was reasonable to conclude that the sale, on its own, was undertaken or arranged primarily for a bona fide business purpose other than to obtain the tax benefit. The court then found that at the time of the reduction of the appellant's ownership of DFR to below 10% and the continuation of the appellant into Luxembourg ("the series of transactions"), DFR had no desire of allowing itself to be sold to any buyer. It concluded that the sale could not be included in that series because of the mere possibility of a future potential sale of any shares.

As the Tax Court found that the sale was not an avoidance transaction, it was not necessary to analyse whether the sale was abusive under the GAAR. The court stated, however, that if it were to do such an analysis, it would focus on whether the exemptions relied upon by the appellant in article 13, paragraph 4 of the treaty were misused or abused.

The Tax Court did not agree that the prima facie finding of abuse could arise from the choice of the most beneficial treaty: "There is nothing inherently proper or improper with selecting one foreign regime over another. Respondent's counsel was correct in arguing that the selection of a low tax jurisdiction may speak persuasively as evidence of a tax purpose for an alleged avoidance transaction, but the shopping or selection of a treaty to minimize tax on its own cannot be viewed as being abusive. It is the *use* of the selected treaty that must be examined."[20]

The court then looked at article 13 of the treaty. Under paragraph 4 of article 13 Canada is allowed to tax the capital gain on the shares of a company that is a resident of Canada, the value of which shares is derived principally from immovable property situated in Canada provided that the taxpayer has a substantial interest in the capital stock of the company. A substantial interest exists when the taxpayer and persons related thereto own 10% or more of the shares of any class of the capital stock of a company. Therefore a capital gain on the sale of an interest of less than 10% in such a company is exempt from Canadian tax. This exemption is not found in the OECD model convention upon which the treaty is based. This led the Tax Court to view as follows: "In drafting those exemptions it must be presumed that Canada had a valid reason to allow Luxembourg to retain the right to tax capital gains in those specific circumstances, for example, the desire to encourage foreign investment in Canadian property. The Appellant's reliance upon a Treaty provision as agreed upon by both Canada and Luxembourg cannot be viewed as being a misuse or abuse."[21]

Finally the court considered the argument that it is possible to deny the treaty benefit based on an anti-abuse rule inherent within the treaty itself. In order to establish an inherent rule the tax authorities presented an expert from Luxembourg. The expert's first argument was that a specific treaty benefit may be denied in situations where both Canadian and Luxembourg domestic anti-avoidance rules would deny that benefit. In order to determine that the Luxembourg domestic anti-avoidance rules would apply, he proposed to review the reversed scenario in which MIL continued into Canada from the Cayman Islands. The court, however, viewed that even if this test were to be accepted, the inherent anti-abuse rule could not be applied without first finding the existence of an abusive avoidance transaction in Canada.

The expert further referred to the articles 26, 31 and 32 of the Vienna Convention on the Law of Treaties. In reviewing the ordinary meaning of the treaty between Luxembourg and Canada, he found that neither article 13 nor any other article of that treaty provided for a specific anti-treaty shopping provision that would authorise Luxembourg under the reversed scenario to deny the treaty benefit's under article 13: "Only the preamble to the tax treaty referring to the prevention of

[20] MIL (Investments) SA v. Canada, 18 August 2006, 2006 TCC 460, at 72.
[21] MIL (Investments) SA v. Canada, 18 August 2006, 2006 TCC 460, at 74.

tax avoidance might be relied upon. That however in my opinion, does not constitute an anti-treaty shopping provision on which Luxembourg could rely upon (…).”[22]

When asked whether paragraph 7 of the commentary to the 1977 OECD model meant ‘if you want an anti-avoidance rule in the treaty, you should put it in the treaty?’ the expert responded he agreed. The tax authorities also presented the 2003 revisions to the OECD commentary as support for the existence of an inherent anti-abuse rule in tax treaties. The Tax Court, in the person of Judge Bell, however, disagreed: “Article 31(1)(c) of the Vienna Convention states "there shall be taken into account, together with the context, any relevant rules of international law applicable in the relations between the parties." I interpret that to mean that one can only consult the OECD commentary in existence at the time the Treaty was negotiated without reference to subsequent revisions.”[23] The Tax Court, again in the person of Judge Bell, concluded as follows: “in light of the OECD commentary and the decision by Canada and Luxembourg not to include an explicit reference to anti-avoidance rules in their carefully negotiated Treaty, I find there is no ambiguity in the Treaty permitting it to be construed as containing an inherent anti-abuse rule. Simply put, the "ordinary meaning" of the Treaty allowing the Appellant to claim the exemption must be respected.”[24] On 13 June 2007 the Federal Court of Appeal confirmed the Tax Court’s decision.[25]

Comments

It is notable that the Canadian and Swiss courts reached opposed conclusions on the issue of whether there is a general anti-abuse rule inherent within tax treaties. Clearly the facts of the cases differed as in A Holding, a Danish holding that was in interposed between Switzerland and Bermuda, received a dividend, whereas in MIL (Investments) a Cayman Island company that migrated to Luxembourg realised a capital gain. However that cannot explain the opposite outcomes of the decisions. In both cases the relevant tax treaty was concluded long before the revision of the commentary of the model treaty in 2003 (the Swiss – Danish tax treaty was concluded in 1973 and the Canadian – Luxembourg tax treaty in 1990). Yet the Swiss court decided that the 2003 commentary on article 1 can be considered a supplementary means of interpretation as it is an intended amendment of already existing rules, whereas the Canadian court ruled that one can only consult the commentary in existence at the time the treaty was negotiated without reference to subsequent revisions. This implies that the courts had different views on the topic of whether the 2003 revision of the commentary on article 1 can be seen as a clarification of already existing rules. In this respect the Canadian court relied on the expert presented by the tax authorities who confirmed that there was no inherent anti-avoidance rule under the 1977 Model Treaty. In the Swiss case, conversely, the commentary prevailing at the time the treaty was concluded was not the 1977 but the 1963 version, that was silent on the issue of abuse of tax treaties. Moreover, the historical background against which the treaty was concluded, more in particular the Swiss 1962 anti-abuse resolution and the fact that Denmark had not made a reservation against the application of this resolution, played an important role in the decision of the Swiss court.[26]

2.4 Dutch Supreme Court: BNB 2007/36 and BNB 2007/42

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[22] MIL (Investments) SA v. Canada, 18 August 2006, 2006 TCC 460, at 81. Besides, the treaty between Luxembourg and Canada is not referring to the prevention of tax avoidance but to the prevention of tax evasion. It is questionable whether the term tax evasion includes tax avoidance. Concurring B.J. Arnold, Tax Treaties and Tax Avoidance: The 2003 Revisions to the Commentary to the OECD Model, Bulletin June 2004, p. 248.

[23] MIL (Investments) SA v. Canada, 18 August 2006, 2006 TCC 460, at 86.

[24] MIL (Investments) SA v. Canada, 18 August 2006, 2006 TCC 460, at 87.

[25] MIL (Investments) S.A. v. Her Majesty the Queen, 13 June 2007, 2007 FCA 236.

[26] In the ITLR editor's note it is suggested that the difference in the conclusions of the two cases may in part be based upon the different background of the legal regimes in Switzerland and Canada: “ Switzerland recognises a general abuse of rights doctrine, while Canada has, it is understood, no such general doctrine but in that context has a statutory general anti-avoidance rule.” 9 ITLR, 26/27

In BNB 2007/36c* a resident of the Netherlands who was the sole shareholder of a company resident in the Netherlands, migrated to Belgium on 15 October 1996. On 24 October 1996 the decision was taken to liquidate the company. A few weeks later, the seat of the Dutch company was moved to Belgium. Shortly thereafter liquidation payments were made by the company to its shareholder. The tax authorities argued that the transfer of seat of the Dutch company to Belgium should be ignored on the basis of fraus conventionis and taxed the liquidation payments as if they were made by a company resident in the Netherlands to a resident of Belgium. The taxpayer, however, claimed that the liquidation payments were made to him by a company resident in Belgium and that as a result the 1970 tax treaty between the Netherlands and Belgium prevented the Netherlands from levying tax. The Court of Appeal agreed with the tax authorities and ruled that it followed from a reasonable application of the treaty that the transfer of the seat of the company to Belgium could not alter the tax consequences of the liquidation payments.

The Supreme Court, conversely, considered as follows: "To the extent that the Court of Appeal's judgement expresses the view that in case the current liquidation payment would not be taxed in the Netherlands, the object and purpose of the tax treaty would be denied, it is incorrect. As the treaty accords consequences to the place of effective management of the company, the treaty cannot be interpreted in such a manner that the intent of the migration still plays a role in respect to the consequences."[27] Thus the liquidation payment could not be taxed.

In BNB 2007/42, the Dutch Supreme Court considered the treatment of a capital gain realised shortly after the emigration of a Dutch BV and its sole shareholder from the Netherlands to Belgium. Pursuant to the 1970 tax treaty between the Netherlands and Belgium, the taxation over capital gains was allocated to Belgium. One of the issues at stake was the question whether a "reasonable application" of the tax treaty should lead to the outcome that the Netherlands should nevertheless be regarded as competent to tax the capital gain. The Supreme Court held that this was not the case: "As B BV does for purpose of the tax treaty not constitute a resident of the Netherlands, the Netherlands is not permitted to levy income taxation on the litigant. (…) As the treaty connects consequences to the place of effective management of the company whose shares are being alienated, the treaty cannot be interpreted in such a manner that the intent of the migration nevertheless plays a role in respect to those consequences."[28]

Comments

The Supreme Court's decisions seem to suggest that fraus conventionis can never be applied. Under fraus conventionis the facts that avoid taxation are substituted by facts that will lead to taxation. The Supreme Court's reasoning, however, appears to imply that once the facts are determined they cannot be substituted by other facts. Notwithstanding the above, Van Weeghel has argued that the decisions should not be read as a dismissal of fraus conventionis. He suggested that the wording of the judgement may have been caused by the way in which the parties organised their defence.[29] In older decisions the Supreme Court used other language. For example in BNB 1994/294, the Supreme Court held that capital gains which had been re-qualified as dividend for purpose of Dutch national law under the fraus legis doctrine, could not be regarded as dividend in the sense of the tax treaty. Crucially, the Supreme Court held that: "Neither from the text of the treaty, nor from the explanations by the treaty partners it appears that they had the common intention to include, for the application of said Article (…), under dividends income (…) which is treated as dividend with the application of the doctrine of fraus legis under the national law of the state in which (the distributing company) has its residence (…). The position advocated by the Under Minister of Finance before the Supreme Court that in case of non-taxability of the

[27] Dutch Supreme Court, 12 May 2006, BNB 2007/36c*, point 3.3.
[28] Dutch Supreme Court, 14 July 2006, BNB 2007/42, point 3.3.
[29] S. van Weeghel in his note under Dutch Supreme Court, 14 July 2006, BNB 2007/42.

income in the Netherlands the object and purpose of the treaty would be ignored is not supported by the text of the treaty or by the explanations of the contracting states."[30]

So far the Dutch Supreme Court has not allowed the application of fraus legis in treaty situations nor has an appeal to fraus conventionis been successful.[31] Based on its previous judgements it follows that in cases like A Holding the Dutch Supreme Court will probably not apply the doctrine of abuse of law unless there is a clear indication that the common intention of the treaty partners was otherwise.

2.5. Israeli District Court: Yanko-Weiss Holdings

Yanko-Weiss Holdings (1996) Ltd. was a company incorporated in Israel in 1996. In 1999 it moved the registered office, management and activities to Brussels. In 2000 it received a dividend from its Israeli subsidiary and it claimed a reduced rate of withholding tax under the tax treaty between Belgium and Israel of 1972. The Israeli tax authorities, however, claimed that Yanko-Weiss' foreign residency was a fictitious transaction under section 86 of the Israeli income tax ordinance and denied the benefit of the treaty because they believed that the company made improper use of the treaty. The treaty did not contain any specific anti-avoidance provisions. The company appealed and argued that in light of the treaty the tax authorities were precluded from raising the claim of fictitious transaction under domestic law.

The court considered that tax treaties were not designed for use that can be made of them which constitutes improper use of their provisions. It stated that: " [a]n additional justification for the use of anti tax-avoidance measures against treaty abuse is found in the implied condition which is to be read into every treaty, that they are not to be used for improper purposes. This is based in part on art 31 of the Vienna Convention."[32] The court then examined the commentary to the OECD model. It held that the position of the OECD carries substantial weight in matters of interpretation even for treaties where only one state is a member of the organisation. The court recognised that in 2003 the OECD made significant changes to the commentary of the model on the issue of the prevention of tax avoidance and evasion. It concluded that benefits should not be granted by tax treaties in situations where an arrangement constitutes improper use of its provisions. In the view of the court, this also applies for treaties concluded prior to 2003. Therefore the court ruled that the tax authorities should be permitted to raise their claim of artificiality, notwithstanding the apparent applicability of the treaty.

Comments

It is emphasised that the Yanko-Weiss Holdings case is a pre-trial case in which the district court only had to decide whether the treaty prevented the application of the domestic anti-abuse rule. The district court was not called upon to decide what constitutes avoidance. This will be the subject of the trial itself.

The district court rules that there is a general anti-abuse rule inherent in tax treaties. This is largely based on the court's belief that tax treaties were not intended to be used in a manner which is not in good faith or which constitutes improper use. The court based its decision on the 2003 commentary, although it acknowledged the considerable changes that were made. There is no

[30] Dutch Supreme Court, 29 June 1994, BNB 1994/294.

[31] Van Weeghel en De Boer have argued that "[f]ollowing a recent decision of the Hoge Raad, (…), it is a legitimate question whether fraus legis can have treaty effect if either (a) the particular application thereof existed when the treaty was concluded or (b) the treaty partner has an equivalent rule." S. van Weeghel, R. de Boer, Anti-Abuse Measures and the Application of Tax Treaties in the Netherlands, Bulletin August/September 2006, p. 364.

[32] District Court of Tel Aviv-Yafo, 30 December 2008, 10 ITLR, 544.

indication in the court's ruling that the fact that the treaty between Belgium and Israel predated the 1977 commentary was a relevant factor.

3. Beneficial owner

3.1 Background

The term “beneficial owner” was introduced into the OECD Model Tax Convention in 1977 in the dividend, interest and royalty articles. Although this term was not defined, the commentary indicated that an intermediary, such as an agent or nominee, who was interposed between the beneficiary and the payer was not considered the beneficial owner.

Since 2003, the OECD commentaries were updated to clarify that the term “beneficial owner” is not used in a narrow technical sense. Rather it should be understood in its context and in the light of the object and purposes of the convention, including avoiding double taxation and the prevention of fiscal evasion and avoidance. According to the commentary treaty benefits should not be given to a person, other than an agent or nominee, who acts as a conduit for another person who in fact receives the benefit of the income concerned: “For these reasons, the report from the Committee of Fiscal Affairs entitled “Double Taxation conventions and the Use of Conduit Companies” concludes that a conduit company cannot normally be regarded as the beneficial owner, if, though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties.”[33]

The report “Double Taxation Conventions and the Use of Conduit Companies” (often referred to as the Conduit Companies Report), which was adopted by the OECD Council in 1986, points out that the fact that a company’s main function is to hold assets or rights is not itself sufficient to categorise it as a mere intermediary, although this may indicate that further examination is necessary. The report further clarifies that treaty benefits should not be available in cases where a person enters into contracts or takes over obligations under which he has a similar function to those of a nominee or an agent.[34] Given the lack of a clear definition of “beneficial owner”, it does perhaps not come as a surprise that commentators are divided on the interpretation of the term “beneficial owner”.[35]

3.2. French Supreme Court: Bank of Scotland

On 5 November 1992 Bank of Scotland, a resident of the United Kingdom, acquired for a price of app. Frs. 277 mio. the usufruct for three years of non-voting preference shares in Marion Merrel Dow SA, a resident of France. Merrel Dow Pharmaceuticals Inc, a resident of the United States, held 100% of the ordinary shares in the French company. The bank expected to receive preference dividends in the total sum of app. Frs. 270 mio. supplemented by a repayment of the dividend tax credit to which a resident of the United Kingdom was entitled under the tax treaty between France and UK of 1968 of app. Frs. 74 mio. The tax treaty between France and the United States contained no equivalent provisions for the repayment of the dividend tax credit. The US company guaranteed to the bank both the payment of the preference dividends, as well as the payment of supplementary compensation in the case of non-reimbursement of the dividend tax credit by the French authorities. The French tax authorities, however, refused to pay the dividend tax credit. The bank appealed and the Court of Appeal allowed the appeal. Subsequently the minister appealed to the Supreme Court.

[33] Paragraph 12.1 of the commentary on article 10 of the 2003 OECD Model.
[34] Paragraph 14b of the Conduit Companies Report.
[35] See L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 686 – 690.

The French Supreme Court held that it appeared: "manifestly from the arrangements described above that it artificially disguised the reality of a loan contracted by the American company from the British bank involving the delegation to its French subsidiary of the reimbursement in its place of the lender by compensation through preference dividends whose payment it had guaranteed.[36] The court then applied the French abuse of law doctrine and considered that the transactions were entered into for the sole purpose of obtaining the benefit of the reimbursement of the dividend tax credit: "An analysis of these arrangements reveals that the beneficial owner of the dividends under dispute was the American company Merrill Dow Pharmaceuticals Inc which had simply delegated to its French subsidiary the repayment in its place of the loan contracted with the British bank."[37] Consequently the French Supreme Court denied the Banks claim to the tax credit.

Comments

This case could have been decided on the basis of the determination of the facts. If the legal relationship under consideration can be qualified as a loan provided by the bank to the US company, the US company should firstly be regarded as the owner of the preference shares in the French company. In that case the US company must be considered the recipient of the dividends on the preference shares and the bank is deemed to receive interest on its loan to the US company. In that case, the bank clearly is not the beneficial owner of the dividends. The fact that the dividends are paid directly by the French company to the bank does not alter this conclusion, as the Fench company pays the dividends on behalf of the US company. As the bank is deemed to receive interest that is paid by the US company, the treaty between France and the United Kingdom does not apply and accordingly the bank is not entitled to the tax credit. Therefore the present author agrees with De Broe, who submits that "in the end the case deals with the proper characterization of the so-called usufruct arrangement and that it is not relevant to construe the term "beneficial owner' under article 10 of the France-United Kingdom treaty."[38] For that reason the reference to the abuse of law doctrine seems unnecessary. [39]

The case has similarities with the Royal Dutch case. In this case, a stockbroker, a resident of the United Kingdom acquired dividend coupons of shares in Royal Dutch, a resident of the Netherlands from a Luxembourg 1929 holding. The seller could not claim the benefits of the tax treaty between Luxembourg and the Netherlands. The stockbroker argued that the withholding tax rate on the dividends should be reduced from 25% to 15% pursuant to the tax treaty between the Netherlands and the United Kingdom. The Dutch tax authorities, however, refused on the ground that the stockbroker was not the beneficial owner of the dividend. The Dutch Supreme Court provided the following interpretation for the term beneficial owner: "The taxpayer became owner of the dividend coupons as a result of purchase thereof. It can further be assumed that subsequent to the purchase the taxpayer could freely avail of those coupons and, subsequent to the cashing thereof, could freely avail of the distribution, and in cashing the coupons the taxpayer did not act as voluntary agent or for the account of the principle. Under those circumstances the taxpayer is the beneficial owner of the dividend. The treaty does not contain the condition that the beneficial owner of the dividend must also be the owner of the shares and further it is irrelevant that the taxpayer purchased the coupons at the time the dividend had already been announced, because the question who is the beneficial owner must not be answered at the time the dividend is announced, but at the time the dividend is made payable."[40]

[36] French Supreme Court, 29 December 2006, 9 ITLR, 701.
[37] French Supreme Court, 29 December 2006, 9 ITLR, 703.
[38] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 700.
[39] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 701.
[40] Dutch Supreme Court, 6 April 1994, BNB 1994/217.

In this judgement, the Dutch Supreme Court bases his conclusion that there is beneficial ownership on three considerations: (i) the taxpayer is the owner of the dividend coupon, (ii) the taxpayer can freely avail of the coupon, and (iii) the taxpayer can freely avail of the monies distributed.[41] Whilst it is clear from the Dutch Supreme Court's decision that ownership of the shares is not necessary to establish beneficial ownership, the taxpayer should be the owner of the legal title upon which his right to the distribution of dividend is based (here: the coupon). Unlike the French court, the Dutch Supreme Court has with this judgement clarified the criteria for determining beneficial ownership.

3.3. English Court of Appeal: Indofood

In June 2002 the claimant Indofood International Finance Ltd ("the Issuer"), a resident of Mauritius, issued loan notes. On the same day, the Issuer lent the capital so raised to its shareholder, PT Indofood Sukses Makmur TBK ("the Parent Guarantor"), a company resident in Indonesia, on substantially the same terms. Had the Parent Guarantor issued the notes itself it would have been obliged under Indonesian law to deduct 20% of the interest payable to the note holders. By interposing the Issuer the Indonesian withholding tax could be reduced to 10% if the capital so raised was lent on to the Parent Guarantor on terms which complied with the conditions of the tax treaty between Indonesia and Mauritius. The defendant JPMorgan Chase Bank N.A. ("the Trustee") was appointed trustee for the note holders. The Trustee was also appointed as the Principal Paying Agent.

The note conditions provided that the notes would be redeemed at par in June 2007 but might be redeemed earlier if there were a change in the law of Indonesia whereby the obligation of the Parent Guarantor to deduct withholding tax from the interest payable to the Issuer under the loan agreement exceeded the rate of 10% for which the tax treaty between Indonesia and Mauritius provided. In that event the Issuer might redeem the loan notes earlier if such obligation could not be avoided by the Issuer taking reasonable measures available to it.

On 24th June 2004 the Republic of Indonesia gave notice that it would terminate the tax treaty between Indonesia and Mauritius with effect from 1st January 2005. One consequence would be that the obligation of the Parent Guarantor to deduct withholding tax from the interest payments due to the Issuer would be increased to 20%. Moreover, by then both interest and exchange rates had moved to such an extent that it was in the commercial interests of the Parent Guarantor, but not of the note holders, that the loan notes should be redeemed as soon as possible.

Subsequently, the Issuer gave notice to the Trustee of its intention to redeem the loan notes. It certified that there was no reasonable measure that the Parent Guarantor could take to avoid the liability to deduct withholding tax at the higher rate of 20%. The Trustee, however, refused to give its approval on the ground that the Issuer was not entitled to redeem the loan notes because the Trustee was not satisfied that there were no reasonable measures available to avoid the increased liability for withholding tax.

The only 'measure' to be considered was the interposition of a company incorporated in the Netherlands ("Newco") between the Issuer and the Parent Guarantor. It was suggested by the Trustee that such interposition could be effected by an assignment by the Issuer to Newco of the benefit of the loan agreement between the Issuer and the Parent Guarantor. The consequence, as alleged by the Trustee, would be that under the 2002 Double Tax Agreement between the Republic of Indonesia and the Kingdom of the Netherlands ("the Dutch DTA") the withholding tax payable by the Parent Guarantor in respect of its obligation to pay interest to Newco would be 10% or less. One of the issues regarding the application of the Dutch DTA by the courts in

[41] See also: Van Weeghel, S., The Improper Use of Tax Treaties, Series on International Taxation: 19, Kluwer Law International: London-The Hague-Boston, (1998), p. 76 - 77.

Indonesia was whether Newco would be the beneficial owner of the interest payable by the Parent Guarantor.

As the governing law of the notes was English law, the question came to the English court whether the Issuer was entitled to redeem the notes. This in turn required the court to predict the result of an Indonesian court case. The High Court concluded in favour of the Trustee. The Issuer appealed.

In the context of this appeal, both parties were engaged in obtaining, inter alia, expert evidence as to the laws of the Netherlands and of Indonesia and the views of the Director General of Taxes in Indonesia ("DGT") as to the application of the Dutch DTA. By a circular letter dated 7th July 2005 issued by DGT to all tax offices in Indonesia and headed ‘Regarding implementing criteria of beneficial owner as stated in the avoidance of Double Tax Treaty Agreement between Indonesia and other Countries’ the recipients were advised that “the Directorate General of Taxation considers it is necessary to give explanation to give legal certainty regarding the definition on criteria of beneficial owner, as the following:
a. "Beneficial owner" refers to the actual owner of income such as Dividend, Interest, and or Royalty either individual taxpayer or business entity taxpayer that has the full privilege to directly benefit from the income.
b. Herewith, "Special purpose vehicle" in form of "conduit company", "paper box company", "pass-through company" and other similar are not included in "beneficial owner" definition as above.”[42]

The Court of Appeal firstly established that the Issuer extended the proceeds of the loan notes to the Parent Guarantor at the same rate of interest but net of any withholding tax due by the Parent Guarantor. It was agreed on the hearing of the appeal that what had happened in fact was that the Parent Guarantor paid the sums due to the note holders direct to the Trustee as Principal Paying Agent.

The Court of Appeal then stated that “[t]he passages from the OECD commentary and Professor Baker's observations thereon show that the term "beneficial owner" is to be given an international fiscal meaning not derived from the domestic laws of contracting states. As shown by those commentaries and observations, the concept of beneficial ownership is incompatible with that of the formal owner who does not have "the full privilege to directly benefit from the income". I take this phrase from the circular letter from DGT dated 7th July 2005. It is entirely consistent with the various commentaries I have quoted (…) above.

43. The legal, commercial and practical structure behind the loan notes is inconsistent with the concept that the Issuer or, if interposed, Newco could enjoy any such privilege. In accordance with the legal structure the Parent Guarantor is obliged to pay the interest two business days before the due date to the credit of an account nominated for the purpose by the Issuer. The Issuer is obliged to pay the interest due to the noteholders one business day before the due date to the account specified by the Principal Paying Agent. The Principal Paying Agent is bound to pay the noteholders on the due date.

44. But the meaning to be given to the phrase "beneficial owner" is plainly not to be limited by so technical and legal an approach. Regard is to be had to the substance of the matter. In both commercial and practical terms the Issuer is, and Newco would be, bound to pay on to the Principal Paying Agent that which it receives from the Parent Guarantor. This is recognised by what we were told actually happens now as recorded in paragraph 13 above. The Parent Guarantor is bound to ensure that such an arrangement continues lest it is required to pay again under its guarantee to the noteholders contained in the Trust Deed. In practical terms it is impossible to

[42] Indofood International Finance Ltd. V. J.P. Morgan Chase Bank N.A, London Branch, [2006] EWCA Civ 158 (Mar.2, 2006).

conceive of any circumstances in which either the Issuer or Newco could derive any 'direct benefit' from the interest payable by the Parent Guarantor except by funding its liability to the Principal Paying Agent or Issuer respectively. Such an exception can hardly be described as the 'full privilege' needed to qualify as the beneficial owner (…).”[43]

Therefore the Court of Appeal concluded that the interposition of Newco was not a measure available to the Issuer or the Parent Guarantor whereby to avoid the obligation to pay withholding tax at a rate in excess of 10%.

Comments

First of all the value of the decision can be questioned as the UK court is asked to predict the outcome of an Indonesian court case relating to the interpretation of the term “beneficial ownership” in a tax treaty between Indonesia and a third state. In addition none of the judges, nor council, had any background in international tax law.[44]

Secondly, the court rightly considered that the term “beneficial owner” had to be given an international fiscal meaning. It then defined beneficial ownership as “the full privilege to directly benefit from the income”. This definition cannot, however, be derived from the commentary as the commentary only provides a negative description of the term “beneficial owner”. Instead the definition appears to be based on the circular letter issued by the DGT in Indonesia.

In the editor's note of ITLR it is stated that the case: “was an egregious example of payment through a conduit.”[45] Newco would be bound to pay on to the principal paying agent of the notes that which it received from the Indonesian borrower and what happened in fact was that the Indonesian company paid the interest direct to the Principal Paying Agent.

It is submitted that the Conduit Companies Report offers support for the court's decision where it clarifies that treaty benefits should not be available in cases where a person enters into contracts or takes over obligations under which he has a similar function to that of a nominee or an agent. This could be understood to mean that a conduit that is bound to pay on almost everything it receives cannot be considered the beneficial owner of the payments made to it.

On the other hand, based on the commentary, more in particular the phrase: “though the formal owner, it has, as a practical matter, very narrow powers which render it, in relation to the income concerned, a mere fiduciary or administrator acting on account of the interested parties”, it could be defended that only recipients that resemble a fiduciary or administrator cannot be considered the beneficial owner. This appears to be the view of De Broe who submits that the beneficial owner is the person: “who receives income from a debtor in its own name for its own account and includes such income in its profit and loss statement and subsequently uses that income to discharge its liabilities (…).”[46] Had the Court of Appeal followed this explanation, it might have considered the Issuer the beneficial owner of the interest it received from the Parent Guarantor.[47]

3.4. Indonesian District Court: Indah Kiat BV[48]

[43] Indofood International Finance Ltd. V. J.P. Morgan Chase Bank N.A, London Branch, [2006] EWCA Civ 158 (Mar.2, 2006).
[44] 8 ITLR 4.
[45] 8 ITLR 4.
[46] L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 712.
[47] Contra de Broe, who does not disagree with the outcome of the decision of the Court of Appeal because parties did not respect their own structure. L. De Broe, International Tax Planning and Prevention of Abuse, Doctoral Series Vol. 14, IBFD Amsterdam 2008, p. 712.
[48] The summary is based on the translator’s note relating to Indonesian Supreme Court, 21 June 2006, 10 ITLR, 1-12.

In June 1994 Indah Kiat International Finance Company B.V. ("Indah Kiat BV") , a company incorporated in the Netherlands and owned by PT Indah Kiat Pulp & Paper Tbk ("PTIKPP"), an Indonesian publicly listed company, issued notes to various international investors. Indah Kiat BV then further-lent the funds it received from the issuance of the notes to PTIKPP. One of the reasons for using Indah Kiat BV was the protection offered by the tax treaty between Indonesia and the Netherlands. Under the treaty the Indonesian withholding tax on interest payments by PTIKPP to Indah Kiat BV was reduced from 20% to 10%.

The case is not a tax case. Rather, the issue was whether under Indonesian law the parties had acted lawfully in borrowing funds through an issue by the Dutch subsidiary. The treaty shopping aspect was an argument in support of the contention that the arrangements were unlawful.

With respect to the tax issue, the District Court of Bengkalis ruled on 29 September 2004 that the establishment of Indah Kiat BV was intended to circumvent Indonesian tax regulations and avoid Indonesian tax obligations since the issuance of the notes was done by way of a special purpose vehicle. Indah Kiat BV was regarded as a special purpose vehicle since it had no business activities or investments, no officers, office equipment, or employees other than its directors, and its paid-up capital was only US$ 2. The court considered that the treaty required trading and investment activities by any Dutch company seeking to claim treaty protection, and that the existence of neither of these activities was proven during the hearing. On 16 June 2005 the High Court of Pekanbaru affirmed the decision of the District Court. On 21 June 2006 the Supreme Court affirmed the decision of the High Court.

Comments

According to the editor's note in ITLR there has been a great deal of interest in this case, largely because of its similarity to Indofood. As it is not a tax case, however, it is merely of illustrative value.

3.5. Indonesian Tax Court: Transportasi

PT. Transportasi Gas Indonesia ("Transportasi") made interest payments on a loan obtained from its shareholder in Mauritius. During 2003 and 2004 Transportasi withheld 10% on the interest paid on the loan pursuant to article 11 of the Indonesia-Mauritius tax treaty, which stated that the 10% rate applied provided the recipient is the beneficial owner of the income. The Indonesian tax authorities, however, increased the withholding tax rate from 10% to 20% on the grounds that the recipient was not a beneficial owner in the sense of the provisions and requirements set forth in the Circular Letter of the Director General of Taxation to 30 July 2005.

The court examined a number of international sources and concluded that "a beneficial owner is the party who substantially in fact constitutes the actual owner of income and freely can enjoy the income and in the residence country will have tax imposed on such income."[49] The court added that it was for the domicile country to determine if the recipient of the interest was the beneficial owner or not. The court then discussed Indofood, and considered that "if what will be established is an SPV, it will not be the beneficial owner".[50] The court ruled that there must be an international understanding of the term beneficial owner and not one derived from domestic law. The court agreed with the English Court of Appeal that according to the international fiscal meaning, beneficial ownership depends on whether the recipient of income enjoys the full privilege to directly benefit from the income. If, however, the recipient of income is legally, commercially and practically bound to forward the income received, then the recipient is not the beneficial owner.

[49] Indonesian Tax Court, 14 March 2008, 11 ITLR, 417.
[50] Indonesian Tax Court, 14 March 2008, 11 ITLR, 418.

The tax authorities submitted that the Indofood case had a substantial similarity with the case of Transportasi. The court, however, was not certain of this point, and noted that the issuer in the Indofood case was a special purpose vehicle that was not considered the beneficial owner. By contrast, the court concluded that the assertion that the Mauritian shareholder of the Transportasi was not the beneficial owner of the interest income, was not supported by the facts of the case. The court for this reason granted Transportasi's appeal.

Comments

In the comments on Indofood it has been suggested that the value of that decision could be questioned as the UK court was asked to predict the outcome of an Indonesian court case relating to the interpretation of the term "beneficial ownerschip". In Transportasi, an Indonesian court had to decide on the issue. It is interesting to note that the court discusses Indofood and cites the British Court of Appeal's decision with approval.

The Indonesian tax authorities argued that Transportasi was comparable to Indofood and that the Mauritian shareholder should therefore not be considered the beneficial owner of the interest paid to it. The court, however, reached an opposed conclusion apparently because the facts of the case differed from those in Indofood.[51]

Peculiarly, the court stated that it was for Mauritius to determine if the recipient of the interest was the beneficial owner. Indonesia should ascertain the Mauritian position by an exchange of information.

3.6. Canadian Tax Court: Prévost

Prévost was a corporation resident in Canada who declared and paid dividends to its shareholder Prévost Holding B.V. ("PHB.V."), a corporation resident in the Netherlands. The shares of the Netherlands company were owned by Volvo (51%), a resident of Sweden, and by Henlys (49%), a resident of the United Kingdom. Volvo and Henlys were parties to a shareholders agreement that provided, among other things, that not less than 80 percent of the profits of Prévost and PHB.V. were to be distributed to the shareholders. The distribution for a fiscal year was to be declared and paid to shareholders "as soon as practicable" after the end of the fiscal year. PHB.V. had no employees in the Netherlands nor did it have any investments other than the shares in Prévost. The issue was to determine who was the beneficial owner of dividends paid by Prévost in 1996, 1997, 1998, 1999 and 2001. The term "beneficial owner" is found in Article 10, paragraph 2 of the 1986 tax treaty between Canada and the Netherlands.

The parties agreed that PHB.V. was not an agent, trustee or nominee for Volvo and Henlys. Rather, it was the Canadian tax authorities' view that PHB.V. was acting as a mere conduit in favour of Volvo and Henlys upon receiving dividends from Prévost.

The Tax Court, in the person of Judge Rip, held that: "[i]n my view the "beneficial owner" of dividends is the person who receives the dividends for his or her own use and enjoyment and assumes the risk and control of the dividend he or she received."[52] The judge went on as follows: "When corporate entities are concerned, one does not pierce the corporate veil unless the corporation is a conduit for another person and has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it, for example, a stockbroker who is the registered owner of the shares it holds for clients. This is

[51] The facts, at least in that part of the judgement that has been translated, do not make clear whether the Mauritian company was bound to pay on the interest it received. Indonesian Tax Court, 14 March 2008, 11 ITLR, 408.

[52] Prévost Car Inc. v. The Queen, R., TCC 231 (Apr. 22, 2008) at 100.

not the relationship between PHB.V. and its shareholders."[53] The judge then considered that: "[f]or Volvo and Henlys to obtain dividends, the directors of PHB.V. had to declare interim dividends and subsequently shareholders had to approve the dividend. There was no predetermined or automatic flow of funds to Volvo and Henlys even though Henlys' representatives were trying to expedite the process."[54] Therefore he concluded that PHB.V. was the beneficial owner of the dividends. On 6 February 2009 the Federal Court of Appeal confirmed the decision of the Tax Court.[55]

Comments

The Canadian tax authorities had invited the court to determine that the term "beneficial owner" means the person who *can* , as a matter of fact, ultimately benefit from the dividends. That proposed definition was rejected, as it did not appear anywhere in the OECD documents. The federal court of appeal added that: "the very use of the word 'can' opens up a myriad of possibilities which would jeopardise the relative degree of certainty and stability that a tax treaty seeks to achieve."[56] Instead the court favoured the more legalistic approach, which entailed that a corporation is not the beneficial owner if it has absolutely no discretion as to the use or application of funds put through it as conduit, or has agreed to act on someone else's behalf pursuant to that person's instructions without any right to do other than what that person instructs it.

Ward suggests that the court may have been influenced by a number of factors. Firstly he mentions the expert testimony, which proved that the Dutch authorities considered PHB.V. the beneficial owner of the dividends. Secondly, he indicates that in the mutual agreement procedure on this issue the Netherlands apparently had defended the position that PHB.V. was the beneficial owner of the dividends. Canada and the Netherlands, however, had failed to reach agreement. Thirdly Ward claims that the legalistic interpretation of the term "beneficial owner" in the Royal Dutch case played a role.[57]

4. Summary

As regards the existence of a general anti-abuse rule inherent within tax treaties, MIL (Investments) and A Holding are interesting cases. The Canadian and Swiss courts reached opposed conclusions on the issue of whether there is a general anti-abuse rule inherent within tax treaties. In both cases the relevant tax treaty was concluded long before the revision of the commentary of the model treaty in 2003 (the Swiss – Danish tax treaty was concluded in 1973 and the Canadian – Luxembourg tax treaty in 1990). Yet the Swiss court decided that the 2003 commentary on article 1 can be considered a supplementary means of interpretation as it is an intended amendment of already existing rules where the Canadian court ruled that one can only consult the commentary in existence at the time the treaty was negotiated without reference to subsequent revisions. This implies that the courts had different views on the topic of whether the 2003 revision of commentary on article 1 can be seen as a clarification of already existing rules. In this respect the Canadian court relied on the expert presented by the tax authorities who confirmed that there was no inherent anti-avoidance rule under the 1977 Model Treaty. In the Swiss case, conversely, the commentary prevailing at the time the treaty was concluded was not the 1977 but the 1963 version, that was silent on the issue of abuse of tax treaties. Moreover, the historical background against which the treaty was concluded, more in particular the Swiss 1962 anti-abuse resolution and the fact that Denmark had not made a reservation against the application of this resolution, played an important role in the decision of the Swiss court.

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53 Prévost Car Inc. v. The Queen, 2008 TCC 231 (Apr. 22, 2008) at 100.
54 Prévost Car Inc. v. The Queen, 2008 TCC 231 (Apr. 22, 2008) at 102.
55 Prévost Car Inc. v. R., 2009 FCA 57, 26 February 2009.
56 Prévost Car Inc. v. R., 2009 FCA 57, 26 February 2009 at par. 15.
57 D. Ward in 11 ITLR 759.

In respect of beneficial ownership it is interesting to contrast Indofood with Prévost. In Indofood the English Court of Appeal had to predict the result of an Indonesian court case. It defined the beneficial owner as the person who has the full privilege to directly benefit from the income. As the recipient of the interest was bound to pay on what it received, it was not considered the beneficial owner. In Transportasi, the Indonesian Tax Court had to deal with a similar issue. The court cited Indofood with approval but reached the opposite conclusion, namely that the Mauritian recipient of the interest was the beneficial owner (apparently because the facts of the case differed from Indofood). By contrast, the Canadian Tax Court held that the beneficial owner of dividends is the person who receives the dividends for his own use and enjoyment and assumes the risk and control of the dividend he or she received. As a result the Dutch intermediate holding was regarded as the beneficial owner. The most noticeable feature of the cases on beneficial ownership described above, probably lies in the fact that different courts around the globe dealing with the exact same subject matter and citing, in some cases, the exact same material, can reach such wildly different conclusions. What this indicates, is that the OECD commentary on beneficial ownership is – at best – ambiguous.